

**NOT TO BE PUBLISHED IN OFFICIAL REPORTS**

California Rules of Court, rule 8.1115(a), prohibits courts and parties from citing or relying on opinions not certified for publication or ordered published, except as specified by rule 8.1115(b). This opinion has not been certified for publication or ordered published for purposes of rule 8.1115.

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

JOHN SMEAD,

Plaintiff and Respondent,

v.

MICHAEL DANZI,

Defendant and Appellant.

---

ANN BEACHER SMEAD, as TRUSTEE,  
etc.,

Plaintiff and Respondent,

v.

MICHAEL DANZI,

Defendant, Cross-complainant and  
Appellant;

JOHN SMEAD,

Cross-defendant and Respondent.

---

G040931

(Super. Ct. No. 06CC11633)

O P I N I O N

(Super. Ct. No. 06CC12387)

Appeal from an order of the Superior Court of Orange County, Charles Margines, Judge. Affirmed.

Bohm, Matsen, Kegel & Aguilera, James G. Bohm and Suzanne J. Reuben for Defendant and Appellant.

North, Nash & Abendroth, Vicki A. Nash and Christine E. Cwiertny for Plaintiff and Respondent.

\* \* \*

Defendant Michael Danzi and plaintiff Michael Smead each own one-half interest in two business entities, and serve as the entities' only directors. After an investor sued Danzi and the two businesses, Danzi obtained the court's permission to retain counsel to represent the business in the litigation without Smead's approval. Although Danzi initially retained independent counsel for one of the entities, he later retained the law firm representing him to also represent both of the entities. The trial court later granted Smead's motion to disqualify the firm from representing the business entities, finding an actual conflict of interest. The court's order also included appointment of a provisional third director of the businesses to break the deadlock between Smead and Danzi.

Danzi challenges the trial court's disqualification order, contending (1) there was no actual or potential conflict of interest between him and the two business entities; (2) the trial court's order is inconsistent with its prior rulings and Smead failed to comply with the reconsideration requirement of Code of Civil Procedure section 1008;<sup>1</sup> and (3) Smead unreasonably delayed bringing his disqualification motion.

We conclude substantial evidence supports the trial court's order. Smead presented evidence Danzi misappropriated assets from the two companies, potentially justifying a cross-complaint by the companies against Danzi. Despite this conflict of

---

<sup>1</sup> All statutory references are to the Code of Civil Procedure unless otherwise noted.

interest, the firm failed to obtain written permission to continue representing the business from Smead as required under Rules of Professional Conduct, rule 3-310(C).

We also conclude the trial court had not previously ruled on the disqualification issue, therefore not implicating section 1008. Although the trial court's order appointing a provisional director appears inconsistent with the trial court's previous rulings, Smead had not requested this relief in his disqualification motion. Thus, the trial court's appointment of a provisional director constituted a sua sponte order and therefore fell within the trial court's inherent authority to correct its own prior rulings.

Finally, we conclude the trial court did not abuse its discretion in failing to reject Smead's disqualification motion for untimeliness. Although it appears Smead delayed bringing the motion until shortly before trial, Danzi failed to demonstrate extreme prejudice accruing because of this delay. Accordingly, we affirm.

## I

### FACTUAL AND PROCEDURAL BACKGROUND

CL Financial Corporation (CL Financial) was in the business of converting stock vehicles into limousines. Until August 2005, Danzi was the sole shareholder and director of CL Financial. In August 2005, Smead purchased 50 percent of the outstanding shares of CL Financial for \$3 million and became a director of the corporation with Danzi. Concurrent with Smead's stock purchase, Ann Becher Smead as Trustee of the Ann Becher Smead Marital Trust (the trust) agreed to extend a \$6 million line of credit to CL Financial. Smead was a beneficiary and cotrustee of the trust. In addition, Danzi and Smead became the sole members of 2120 Susan Street Partners, LLC (Susan Street Partners), a limited liability company created to purchase a building in Santa Ana to allow CL Financial to increase its production capacity. By the end of August 2006, CL Financial became insolvent after it had exhausted the \$6 million credit line the trust had provided.

In November 2006, the trust sued Danzi, CL Financial, Susan Street Partners, and Coastal Limousine Corporation (Coastal), a corporation wholly owned by Danzi. The trust alleged Danzi obtained the \$6 million credit line by falsely representing CL Financial's financial condition. The trust also alleged Danzi misappropriated the proceeds of the credit line and made unauthorized transfers of CL Financial's assets to Susan Street Partners and Coastal, including manufacturer's certificates of ownership (MSO) on the vehicles CL Financial converted to limousines.

Danzi filed a cross-complaint against Smead, alleging that any damages to the trust resulted from Smead's mismanagement of CL Financial. In particular, Danzi alleges Smead falsely represented himself as an expert in production management, control, and inventory systems, but "ran the company into the ground with massive cost-overruns, poor management, failed cost controls, failed control on inventory, and a failure to ever properly implement new production accounting software."

Smead filed a separate action against Danzi and CL Financial (Smead action), alleging Danzi induced Smead to invest in CL Financial by misrepresenting the company's financial condition. CL Financial did not respond to Smead's suit, and a default was entered against the company. The court consolidated the Smead action with the trust action for trial.

In January 2007, Danzi filed a motion for authority to appear and defend on behalf of Susan Street Partners in the trust action, arguing that Smead, as 50 percent owner in Susan Street Partners, would not allow the partnership to hire counsel to defend the action. Danzi asserted Smead's refusal to engage counsel in defense of Susan Street Partners was prompted by Smead's status as a cotrustee and beneficiary of the trust. Smead opposed the motion, arguing that Susan Street Partners was insolvent, and that it should not be subjected to further financial liability for attorney fees because Danzi's wrongful acts resulted in Susan Street Partners' insolvent financial condition. On March 7, 2007, the trial court granted Danzi's motion.

Danzi engaged independent counsel, Lawrence Burek, to represent Susan Street Partners. In February 2008, Danzi engaged his own counsel, Bohm, Matsen, Kegel & Aguilera, LLP (BMKA), to substitute in as attorneys of record for Susan Street Partners. On February 21, 2008, Smead's counsel sent a letter to Danzi's counsel objecting to the substitution based on "obvious conflicts of interest," and demanded BMKA's immediate withdrawal from representing Susan Street Partners.

On March 17, 2008, Danzi moved via ex parte application in the trial court for an order authorizing him to appear and defend on behalf of CL Financial, making the same arguments he asserted in his motion for authority to defend Susan Street Partners. Smead opposed the ex parte application, arguing the proper procedure for dealing with a deadlock would be to appoint a provisional director or receiver. The court granted Danzi's ex parte application, giving him authority to appear and defend on behalf of CL Financial, provided Danzi funds the defense. Danzi then engaged BMKA to represent CL Financial.

At the March 17, 2008 hearing, Smead's counsel expressed an intention to file a motion to disqualify BMKA from representing Susan Street Partners and CL Financial based on conflicts of interest. On June 19, 2008, Smead's counsel sent letters to Danzi's counsel objecting to BMKA's representation of Susan Street Partners and CL Financial and demanding BMKA's immediate withdrawal. Danzi's counsel responded to both letters on June 23, 2008, refusing to withdraw as counsel for the two companies. On July 9, 2008, two months before the scheduled September 8, 2008, trial date, Smead filed motions to disqualify BMKA as attorneys for CL Financial and Susan Street Partners. On August 20, 2008, the trial court granted Smead's disqualification motions, finding the disqualification motion timely, and that an actual conflict of interest existed between BMKA's representation of Danzi and the two companies. The court further ordered: "Because Mr. Danzi and Mr. Smead each own 50% of CL Financial and Susan Street [Partners], and because they are at a complete impasse when it comes to operating the

businesses, the Court will appoint a provisional director pursuant to Corporations Code section 308 to act as a third director of the companies. The appointment will be as to all cases before this Court involving these entities.” Danzi now appeals the trial court’s order.<sup>2</sup>

## II

### STANDARD OF REVIEW

“Generally, a trial court’s decision on a disqualification motion is reviewed for abuse of discretion. [Citations.] If the trial court resolved disputed factual issues, the reviewing court should not substitute its judgment for the trial court’s express or implied findings supported by substantial evidence. [Citations.] When substantial evidence supports the trial court’s factual findings, the appellate court reviews the conclusions based on those findings for abuse of discretion. [Citation.] However, the trial court’s discretion is limited by the applicable legal principles. [Citation.] Thus, where there are no material disputed factual issues, the appellate court reviews the trial court’s determination as a question of law. [Citation.] In any event, a disqualification motion involves concerns that justify careful review of the trial court’s exercise of discretion. [Citation.]” (*People ex rel. Dept. of Corporations v. Speedee Oil Change Systems, Inc.* (1999) 20 Cal.4th 1135, 1143-1144 (*Speedee Oil*).) An abuse of discretion occurs where “the trial court exceeded the bounds of reason.” (*Mercury Ins. Group v. Superior Court*, (1998) 19 Cal. 4th 332, 349.)

---

<sup>2</sup> An order disqualifying counsel is immediately appealable as an order on a collateral matter similar to an order granting or denying an injunction. (See *Reed v. Superior Court* (2001) 92 Cal.App.4th 448, 450.)

### III

#### DISCUSSION

##### A. *Substantial Evidence Supports the Trial Court’s Finding of a Conflict of Interest*

A motion to disqualify an opposing party’s counsel touches upon several important interests, involving “a client’s right to chosen counsel, an attorney’s interest in representing a client, the financial burden on a client to replace disqualified counsel, and the possibility that tactical abuse underlies the disqualification motion. [Citation.] [Fn. omitted.] Nevertheless, determining whether a conflict of interest requires disqualification involves more than just the interests of the parties.” (*Speedee Oil, supra*, 20 Cal.4th at p. 1145.)

“A trial court’s authority to disqualify an attorney derives from the power inherent in every court ‘[t]o control in furtherance of justice, the conduct of its ministerial officers, and of all other persons in any manner connected with a judicial proceeding before it, in every matter pertaining thereto.’ [Citations.] Ultimately, disqualification motions involve a conflict between the clients’ right to counsel of their choice and the need to maintain ethical standards of professional responsibility. [Citation.] The paramount concern must be to preserve public trust in the scrupulous administration of justice and the integrity of the bar. The important right to counsel of one’s choice must yield to ethical considerations that affect the fundamental principles of our judicial process.” (*Speedee Oil, supra*, 20 Cal.4th at pp. 1145-1146.)

The present case concerns an alleged conflict of interest arising from the concurrent representation of two parties having adverse interests. On this subject, California Rules of Professional Conduct, rule 3-310(C), provides: “A member shall not, without the informed written consent of each client: [¶] (1) Accept representation of more than one client in a matter in which the interests of the clients potentially conflict; or [¶] (2) Accept or continue representation of more than one client in a matter in

which the interests of the clients actually conflict; or [¶] (3) Represent a client in a matter and at the same time in a separate matter accept as a client a person or entity whose interest in the first matter is adverse to the client in the first matter.”

We conclude substantial evidence supports the trial court’s determination that an actual conflict exists between BMKA’s representation of Danzi and its representation of CL Financial and Susan Street Partners. Specifically, Smead included his own declaration in support of the disqualification motions, detailing how Danzi removed \$400,000 from Susan Street Partners without authorization; used CL Financial funds to pay Danzi’s personal expenses; liquidated CL Financial assets without Smead’s approval; and removed MSO’s belonging to CL Financial without Smead’s approval, and transferred them to other persons and entities, including Coastal Limousine, a company wholly owed by Danzi.

At a minimum, facts demonstrating Danzi transferred MSO’s belonging to CL Financial without authority arguably present a defense to the trust’s claim that CL Financial improperly transferred the MSO’s. Yet, in CL Financial’s answer, BMKA did not assert this defense; instead, the answer alleged Smead, in part, caused the damages to the trust. As the trial court noted, Danzi’s alleged misappropriation of assets may justify CL Financial filing an indemnity cross-complaint against Danzi. But BMKA filed a cross-complaint only against Smead, which the court later dismissed. Although we do not decide whether CL Financial may assert a valid defense to the trust’s claims based on Danzi’s unauthorized acts, or that a cross-complaint against Danzi would be meritorious, Danzi’s acts described in Smead’s declaration demonstrate an actual conflict of interest between Danzi and the two entities.

The present case resembles the situation in *Tsakos Shipping & Trading, S.A. v. Juniper Garden Town Homes, Ltd.* (1993) 12 Cal.App.4th 74, 95 (*Tsakos*), in which the managing partner of a limited partnership borrowed \$35,000 from the plaintiff and executed an agreement requiring the partnership to guarantee the loan. After the



managing partner defaulted, plaintiff sued the managing partner and the partnership. The general partner hired an attorney to represent both him and the partnership, but did not obtain the consent of the other partners to having an attorney represent both the general partner and the partnership, or even notify them of the pending action. The creditor recovered a judgment against the general partner and partnership, and entered a sister state judgment in California. The trial court denied the other partners' motion to set aside the judgment.

The appellate court in *Tsakos* reversed, holding the attorney's dual representation of both the general partner and the partnership deprived the partnership of a fair trial, observing: "An attorney's simultaneous representation of clients with differing interests presents a classic situation of conflict. Each client is entitled to unimpaired loyalty of counsel; an attorney representing clients with conflicting or potentially conflicting interests may be tempted to favor the interests of one over the other. [Citation.] [¶] *Here, the conflict was actual. Diligent representation of [the partnership] required [the attorney] to raise the defense that [the general partner]'s execution of the guaranty agreement was outside the scope of his authority as a partner under the partnership agreement. [Fn. omitted.] Conceivably, he should even have filed a cross-complaint by [the partnership] against [the general partner] for fraud or indemnification. This defense would have worked to [the general partner]'s detriment. . . . [¶] Dual representation under such circumstances resulted in the denial of a fair trial.*" (*Tsakos, supra*, 12 Cal.App.4th at p. 96, italics added.)

Danzi contends no actual conflict of interest exists here because the evidence of Danzi's malfeasance consisted only of Smead's self-serving declaration. Danzi claims Smead's assertions are false, and that having CL Financial or Susan Street Partners bring a cross-complaint against Danzi would constitute malicious prosecution.

Again, we do not decide whether the business entities may employ the facts Smead asserts as a defense in the action or as the basis for a cross-complaint against

Danzi. We similarly do not decide the truth of Smead's declaration. We simply observe that Smead's declaration constituted substantial evidence of a conflict of interest. The trial court was not required to wait until the facts are presented at trial to determine whether a conflict of interest exists.

Danzi next contends that even if Smead's assertions were accepted, neither CL Financial nor Susan Street Partners could seek indemnity against him. Danzi relies on Labor Code section 2802, subdivision (a), which provides that "[a]n employer shall indemnify his or her employee for all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties . . . ." Smead's assertions of malfeasance against Danzi, however, do not concern acts taken "in direct consequence of the discharge of his . . . duties." Instead, Smead asserts Danzi's acts, which included misappropriation of the assets of the businesses, were taken without authorization for his own personal benefit. "An employer is not vicariously liable for an employee's conduct if the employee substantially deviates from his or her course of duty so as to amount to a complete departure." (*Jacobus v. Krambo Corp.* (2000) 78 Cal.App.4th 1096, 1101-1102.) Danzi cannot credibly argue that a misappropriation of corporate assets falls within an employee's course of duty.

Danzi also contends the companies may not bring an indemnity action against him because of the indemnity provisions in the bylaws of CL Financial and Susan Street Partners. We disagree.

The bylaws of CL Financial provide that "[e]ach person who was or is made a party . . . in any action, suit or proceeding . . . by reason of the fact that he or she is or was a director or officer of the Corporation . . . shall be indemnified and held harmless by the Corporation to the fullest extent authorized by the Delaware General Corporation Law . . . ." California Corporations Code section 2115, however, provides that with corporations such as CL Financial, Corporations Code section 317 — not the law of a foreign state — governs the limits of indemnification. Under Corporations Code

section 317, a director or officer is only entitled to indemnification “if the person acted in good faith and in a manner the person reasonably believed to be in the best interests of the corporation . . . .” Although a corporation can indemnify its officers and directors for their negligence or mistakes, it may not indemnify an agent who has acted in bad faith or is guilty of intentional misconduct. (*Wilshire-Doheny Associates, Ltd. v. Shapiro* (2000) 83 Cal.App.4th 1380, 1389.)

Similarly, Susan Street Partners, a California limited liability company, is bound by Corporations Code section 17155, subdivision (a), which allows for indemnification “[e]xcept for a breach of the duty set forth in Section 17153 . . . .” Corporations Code section 17153 provides that “[t]he fiduciary duties a manager owes to the limited liability company and to its members are those of a partner to a partnership and to the partners of the partnership.” These duties include the duty of loyalty, the duty of care, and the duty of good faith and fair dealing. (Corp. Code, § 1640, subds. (a)-(d); *Enea v. Superior Court* (2005) 132 Cal.App.4th 1559, 1565.) Because the facts asserted by Smead in his declaration regarding Danzi’s misappropriation of assets fall outside of the allowable limits of indemnification under the Corporations Code, the bylaws of CL Financial and Susan Street Partners do not prevent a cross-claim by either of the companies against Danzi.

**B. *The Trial Court Was Not Required to Follow the Statutory Procedures for Reconsideration of Its Prior Rulings***

Danzi contends the trial court erred because its order disqualifying BMKA was inconsistent with its prior rulings, and Smead failed to follow the procedures set out in section 1008 for motions for reconsideration. Not so.

The portion of the trial court’s order disqualifying BMKA was not inconsistent with the court’s previous rulings. When the court granted Danzi authority to retain counsel to defend CL Financial and Susan Street Partners, the trial court did not

rule on whether Danzi's counsel could represent the two business entities. Specifically at the March 7 hearing, Smead's counsel, Vicki Nash, asked whether Danzi could hire his own counsel for the business entities, noting "We think there's a conflict." The court responded: "I'm certainly in no position to make that ruling now. So if he does, then I suppose there will be a motion before me. I can't make the ruling now. I think it's the kind of thing that ought to be fully briefed. And it may not even come to pass."

Similarly, at the March 27 hearing, the following interchange occurred: "MS. NASH: We just learned that counsel is purporting to represent 2120 Susan Street Partners. We do plan to come in on a motion to disqualify. They have not provided any legal authority for their ability to do that, and there is a clear conflict in this case, because I want to be clear what you are ruling. We do intend to bring a motion to disqualify them as counsel because they told me — [¶] THE COURT: Okay, that's fine. That's for another later date."

Accordingly, the issue of whether a conflict of interest prevented BMKA from jointly representing Danzi and the two business entities had never been decided by the court. Thus, the reconsideration procedures of section 1008 never came into play.

Nonetheless, that portion of the trial court's order appointing a provisional director may be viewed as inconsistent with its earlier ruling granting Danzi sole authority to appoint counsel to defend the business entities. But Smead did not request appointment of a provisional director in his disqualification motion. The trial court therefore made the appointment sua sponte.

"[A] trial court has inherent authority to correct an erroneous ruling on its own motion." (*In re Marriage of Barthold* (2008) 158 Cal.App.4th 1301, 1303.) "If a court believes one of its prior interim orders was erroneous, it should be able to correct that error no matter how it came to acquire that belief." (*Le Francois v. Goel* (2005) 35 Cal.4th 1094, 1108.) Thus, the trial court had inherent authority to change its decision on whether to appoint a provisional director. That the court's decision to do so may have

been prompted in part by Smead's motion to disqualify BMKA did not convert the disqualification motion into a reconsideration motion.

C. *The Trial Court Did Not Err in Rejecting Danzi's Claim the Disqualification Motion Was Untimely*

Danzi contends the trial court abused its discretion in granting the disqualification motion because Smead unreasonably delayed bringing the motion, waiting until just weeks before trial. We disagree.

"Because of the law's concern for unhampered counsel on both sides of the litigation, 'mere delay' in making a disqualification motion is not dispositive. The delay must be extreme in terms of time and consequence." (*River West, Inc. v. Nickel* (1987) 188 Cal.App.3d 1297, 1311 (*Nickel*).) In *Nickel*, the trial court granted the disqualification motion of one of the defendants, Nickel, after a delay over 30 months. Reversing the trial court's order, the appellate court first determined that waiting 30 months before filing a disqualification motion constituted an unreasonable delay. (*Id.* at p. 1313.)

The court then considered whether the delay prejudiced the plaintiffs: "During [the time of the delay], plaintiffs' counsel engaged in substantial discovery directed at Nickel and other defendants. One of the complained-of attorneys . . . examined over 200 files in the offices of Nickel's Sacramento counsel. [¶] Having allowed plaintiffs' counsel to engage in over 3,000 hours of litigation effort at a cost of \$387,000 constitutes prejudice in more than time and dollars expended. The fruits of discovery presumably were shared by plaintiffs and their counsel. We can assume there is a substantial 'work product' in the hands of plaintiffs' counsel. The right to its possession and interpretation would become a serious and complex issue if counsel were disqualified prior to its use. This unnecessary complication and prejudice is a direct by-product of the delay. [¶] Under these conditions, we find the delay in making the

disqualification motion so unreasonable and the resulting prejudice so great, that the law must assume an implied waiver of the right to disqualify [the challenged attorney]; defendant Nickel is therefore estopped from asserting otherwise.” (*Nickel, supra*, 188 Cal.App.3d at p. 1313.)

Here, Danzi devotes his argument exclusively to the timing of the disqualification motion. Unlike the plaintiff in *Nickel*, Danzi makes no showing of any prejudice suffered as a result of that delay, other than to note that the timing of the motion required a continuance of the trial date. Absent a showing of extreme prejudice, we cannot say the trial court abused its discretion in granting the motion.

#### IV

#### DISPOSITION

The order is affirmed. Smead is entitled to his costs of this appeal.

ARONSON, J.

WE CONCUR:

RYLAARSDAM, ACTING P. J.

IKOLA, J.